NO. 12544

In The United States Court of Appeals
For the Ninth Circuit

MATANUSKA VALLEY FARMERS COOPERATING ASSOCIATION, a Corporation, *Appellant,*

vs.

C. R. MONAGHAN, *Appellee.*

APPEAL FROM THE DISTRICT COURT,
TERRITORY OF ALASKA,
THIRD DIVISION

BRIEF OF APPELLANT

DAVIS & RENFREW,
Anchorage, Alaska,

HOUGHTON, CLUCK, COUGHLIN & HENRY,
535 Central Building,
Seattle 4, Washington,
Attorneys for Appellant.

535 Central Building,
Seattle 4, Washington.

THE ARGUS PRESS, SEATTLE

NO. 12544

In The United States Court of Appeals
For the Ninth Circuit

MATANUSKA VALLEY FARMERS COOPERATING ASSOCIATION, a Corporation, *Appellant,*

vs.

C. R. MONAGHAN, *Appellee.*

APPEAL FROM THE DISTRICT COURT,
TERRITORY OF ALASKA,
THIRD DIVISION

BRIEF OF APPELLANT

DAVIS & RENFREW,
Anchorage, Alaska,

HOUGHTON, CLUCK, COUGHLIN & HENRY,
535 Central Building,
Seattle 4, Washington,
Attorneys for Appellant.

535 Central Building,
Seattle 4, Washington.

THE ARGUS PRESS, SEATTLE

INDEX

TABLE OF CASES

TEXTBOOKS

STATUTES

In The United States Court of Appeals
For the Ninth Circuit

MATANUSKA VALLEY FARMERS COOPERATING ASSOCIATION, a Corporation, *Appellant,* vs. C. R. MONAGHAN, *Appellee.*	No. 12544

APPEAL FROM THE DISTRICT COURT,
TERRITORY OF ALASKA,
THIRD DIVISION

BRIEF OF APPELLANT

I.

STATEMENT RELATING TO PLEADINGS AND JURISDICTION

This is an appeal from a judgment against appellant (hereinafter called the Association) rendered by the District Court for the Territory of Alaska, Third Division. The judgment was for $28,700.60 and costs (R. 129-130).

Jurisdiction of the District Court is conferred by Title 48 U.S.C.A. Sec. 101 and 2 Alaska Compiled Laws Ann., 1949, Title 53, Sec. 53-1-1. Jurisdiction of this court to review the judgment of the District Court is conferred by New Title 28 U.S.C.A. Sec. 1291. By the terms of Title 48 U.S.C.A. Sec. 103a the Federal Rules of Civil Procedure were made applicable to the Territory of Alaska as of July 18, 1949.

The following facts were pleaded by the appellee, as

plaintiff below, in his complaint (R. 2-4) and admitted by the Association in its Answer (R. 73-75) : The Association is a corporation organized under the laws of Alaska engaged in the business of buying, selling, handling and processing agricultural products on a cooperative basis; the business is done at or near Palmer, Alaska, with its stockholder-members (R. 2, 73). The plaintiff is a stockholder-member of the Association and during the period December 1, 1944, ending November 30, 1945, he was engaged in the dairy business near Palmer. During this period, and prior thereto, he sold a stated quantity of milk to the Association under the terms of a written contract with it (R. 3, 73). A copy of the contract, called "Member's Standard Marketing Contract," is attached to plaintiff's complaint as Exhibit A (R. 58-73). The Association commingled plaintiff's milk with that sold to it by other dairymen-stockholders and then resold such milk and products made by it therefrom (R. 3-75).

In twenty succeeding causes of action the plaintiff alleged the assignment of each to him, and essentially the same facts with reference to each assignor as those set forth above (R. 4-58). Aside from denying such assignment upon information and belief, which was proved at the trial (R. 169-174), the defendant made corresponding admissions of these facts (R. 76-109).

In its Answer the Association alleged, as to each cause of action, that it purchased and paid for all milk delivered at a fixed price, which varied from time to time during the year (R. 74-109).

At the conclusion of the trial the court rendered an

oral opinion (R. 590-595). It then entered Findings of Fact which follow closely the admitted facts as set forth above (R. 122-128) and the Conclusion of Law that plaintiff was entitled to recover in the sum above mentioned (R. 128).

II.

STATEMENT OF THE CASE

When stated accurately, the facts emerge as being virtually uncontroverted. The Association is incorporated as a "co-operative business corporation" under Title 26, Chapter 3, Alaska Compiled Laws (1949) Sec. 36-3-1 and following. Its Articles and By-Laws are in evidence (Defendant's Exhibit 2, R. 302, 149).

The Member's Standard Marketing Contract referred to above, is a form contract in use by the Association and its shareholders since 1937, and prior thereto (R. 168). It was executed not only with dairymen but also with the other producers and growers of agricultural products selling them to the Association (R. 377).

The Association is almost unique in structure and method of operation. The Alaska Rural Rehabilitation Corporation and other agencies of the United States had established a group of enterprises near Palmer, as a kind of civic center, to serve both growers and consumers (R. 572, 358). This was in furtherance of a policy to foster the development of agriculture in the Matanuska Valley by citizens of the United States. These operations had shown a heavy loss. The Co-operative was notified that unless it acquired them they

would be closed down (R. 356). After a trial period, in which the Association acquired and operated three "departments" only, it acquired all of them in January, 1940, borrowing from the United States $300,000.00 to cover the purchase price (R. 357).

The Association operated, or continued to operate, the enterprises thus acquired in rather loosely defined "departments." First, there are the "consumer departments." These are defined as the Warehouse, Trading Post (retail store), Garage, or any unit in which the Association buys from some source other than the farmers for resale to the farmers as consumers (R. 363-364). Then there are the "producer departments," consisting of "Produce" and "Dairy Creamery" and any unit in which products are procured from farmers for resale (R. 363-364).

The Association soon put the operations as a whole on a profit-making basis. It even refunded to the Government monies advanced by it ($7,000 per month) to defray heavy losses anticipated on the basis of prior experience (R. 357-358).

However, each year thereafter some departments showed a profit while others showed a loss. In 1940 when the properties were acquired the "creamery" department was among those showing a heavy loss (R. 572), while others showed a profit (R. 376). At that time the dairymen were marketing their product in the form of sour cream (R. 572). Shortly afterwards the Association constructed a dairy-creamery plant at Anchorage, established retail routes for direct-to-consumer sales, and engaged in the processing and manufacture

of dairy products (R. 572-574). Dairymen thereafter marketed their product to the Association in the form of milk instead of sour cream, at considerably higher prices (R. 573). From 1941 on the dairy-creamery department consistently showed a profit, which was large in comparison with that of other departments.

As to the dairymen, the practice for years was for the Association to make a payment on the 5th and 20th of each month as to milk delivered during the preceding two weeks. The dairymen received slips whenever they delivered milk showing the poundage delivered, the butterfat test, the price of the milk and the amount of money to be paid therefor on the succeeding bi-monthly payment date (R. 437). The Association made payments regularly to each dairyman in accordance with a price per hundred pounds of milk delivered, fixed from time to time by its Board of Directors. The prices paid by the Association from 1941 through 1946 are set forth in Defendant's Exhibit 4 (R. 306).

The procedure for determining the amount of any annual payment or credit to the shareholders was described in detail (R. 352-354, 361-365, 374-376, 453-456, 465-575, 573, 575-576). In brief it was as follows: In the Spring of each year, the Association caused an audit to be made of its books, covering the preceding fiscal year. The audit showed the profit, if any, made by the Association and that credited to each department. The Association then pro-rated its profit to those departments, and those only which showed a profit, in proportion that the profit of each bore to the total profit of the Association. At the same time, it pro-rated the sum

credited to each profit-making department to the individual producers and consumers patronizing it in proportion of their patronage, i.e., the dollar volume of purchases by consumers and the dollar volume of sales by producers. It paid the producers this sum in cash, but gave consumers 10-year notes or "certificates of equity," utilizing the cash covered thereby as its sole reserve to pay off its note to the Government.

In the Spring of 1946 the audit of the Association for the preceding fiscal year, involved in this suit, showed that the Association had a profit of only $2,889.27 (R. 181-182) without allowance for any payment on its note to the government. If a reserve had been set up for that purpose, a deduction of $6,000 from that figure would be necessary, putting the Association in the red for the year 1945 (R. 359). This compared with an Association profit of about $60,000 for the preceding year 1944 (R. 352).

The profit shown for the creamery-dairy department for 1945 was $57,001.85 (R. 181-182) with two other departments showing smaller profits, others showing losses (R. 300). The plaintiff and his assignors demanded payment of the proportion of the full $57,-001.85 in ratio to their sales. This demand was refused on the ground that compliance therewith would involve an illegal depletion of the corporation's capital, and as being contrary to the member's contract (R. 576). Plaintiff then brought suit.

III.

QUESTION INVOLVED

The question presented by this appeal is: were the shareholders of the Association who sold milk to it and received bi-monthly payments therefor during the fiscal year 1945 (December 1, 1944, to November 30, 1945) entitled to the profit shown on its books for the creamery-dairy department ($57,001.85) even though the Association for that year showed a profit of only $2,800 for all departments even without provision for any annual reserve ($6,000.00) necessary to pay its note to the United States?

IV.

SPECIFICATIONS OF ERROR

1. The District Court erred as to its Finding of Fact Number V, particularly that portion thereof to the effect that the defendants promised to pay for the milk delivered under paragraphs (6) and (7) of the contract, and that by reason of the premises there became due and owing to the plaintiff and his assignors from defendant on the 1st day of July, 1946, after deduction of the items stated in paragraph (7) of said contract, the aggregate sum of $28,700.60, no part of which has been paid (R. 126-127).

2. The District Court erred as to its Conclusion of Law, that the plaintiff is entitled to recover in the sum above mentioned (R. 128).

3. The District Court erred in making and entering its Judgment for the payment of the sum above mentioned (R. 129-130).

Since these Specifications of Error all relate to the same question of law, we shall discuss them together.

V.

ARGUMENT

It will be noticed that the District Court made no finding of fact whatsoever beyond the facts alleged by plaintiff in his complaint and admitted by the Association in its answer. It is true that the court's Finding of Fact V favored one of the plaintiff's contentions, that the milk was sold by plaintiff and his assignors under paragraph (7) of the contract, rather than under other provisions of the contract as defendant contended. However, this is in substance a conclusion of law, not one of fact.

Furthermore, it is emphasized that the essential facts in this case, as contrasted with conclusions drawn from facts, will be found to be virtually uncontroverted when all the evidence is reviewed.

The case thus comes up to this court presenting essentially questions of law. Therefore, no principle favoring determinations made by a trial court upon disputed facts serves as any barrier to an adjudication of the issues presented herein upon their merits. Furthermore, this court has held expressly that it exercises its independent judgment in any appeal from a Judgment of the District Court for the Territory of Alaska.

> *Carscadden v. Territory of Alaska* (C.C.A. 9, 1939) 105 F. (2d) 377, 383.

The argument to be presented herein may be summarized as follows, consistent with the headings to be adopted:

1. When all provisions of the contract are reviewed

together and related to their underlying purpose it is evident that appellee's interpretation would completely defeat their purpose. The contract was executed with all producers who sold varied agricultural products to the Association. The purpose was to further a broad business venture on a non-profit, self-supporting basis, by which all shareholders could market their products on favorable terms and likewise purchase needed supplies and commodities of various kinds. Appellee would defeat this purpose by draining off the profit from all profit-making departments each year, leaving the Association with annual losses only.

2. The interpretation of the contract under long-established practice of the parties is to be given great, if not controlling consideration. This would be so either as effecting a modification of a written contract made many years ago (prior to 1937), or as embodying rules and regulations subsequently adopted to which each producer in paragraph (1) of the contract agreed to be bound. At the least, the practice would have great weight as reflecting the interpretation placed upon the contract by the parties themselves.

3. The practice of the parties, since the inception of their operations in 1940 was for the Association to distribute or credit any net profit of the Association as a whole back to those departments which showed a profit for the year, as a basis of allocating it to the individual shareholders who sold products to, or purchased them from the Association, a profit-making department. The dairymen during the entire period had a majority on the Association's board, and controlled

the procedure. They were satisfied with it and implicitly recognized its justice. Their complaint in 1946 arose as to the preceding year because it happened that the Association had no profit to distribute for the year 1945, or at most about $2,800.

4. Paragraph (7) of the Contract, providing for the payment of products pooled pursuant to paragraph (6), on the basis of resale price received less stated deductions, does not apply. The milk was not pooled in accordance with paragraph (6) because this paragraph contemplates an identifiable pool of like products by grade whereas the milk was commingled with many other unlike products regardless of grade. If the dairymen had deemed paragraphs (6) and (7) applicable they would have demanded an accounting and remittance at the end of each bi-monthly period, when all milk for the preceding two weeks normally was resold. To avoid the connotation of "price," appellee attempted to classify the regular bi-monthly payments to producers for milk delivered as "advances" made in the discretion of the Association. In substance they were not, for several reasons stated.

5. However, even if paragraph (7) were held to govern, the position of the appellant still would be well taken because the deductions therein authorized must be construed by reference to long-established practice. The plaintiff misapplied the concept of "indirect overhead" under the practice of the parties; this had been used as a rule-of-thumb to assist in the break-down of Association profit to the profit-making departments and does not constitute any basis for draining off the

profit credited on the books to a particular department in a year when the Association as a whole made no profit.

6. The practice of the parties demonstrates that they did their business in accordance with paragraph (8), authorizing the Association to pay a flat delivery price as to products processed or manufactured into changed or new products. In substance the bi-monthly payments were the price paid from time to time for milk delivered pursuant to terms of cash sales thereof, and the payment when made to cover the year's business was a dividend proportioned upon sales. The Association processed or manufactured the milk within the meaning of paragraph (8) and did so at its own expense and as its own product.

7. The payment of the amount demanded by plaintiff would constitute an illegal payment of dividends out of capital rather than out of net profits, contrary to the common law, the statute under which the Association was incorporated, and its Articles and By-laws.

1.

Provisions of Contract Summarized; Appellee's Interpretation Would Completely Defeat Their Purpose.

The provisions of the Member's Standard Marketing Contract may be summarized rather briefly. In the opening recital it is stated that the contract is between the "Matanuska Valley Farmers Cooperative Association" and the "Producer" (R. 58). The word "Cooperative" had been changed to "Cooperating" in the Association's name in 1937 but the contract form had

been printed prior to that date and the correction not made to correspond (R. 168). It is recited that the Matanuska Valley Colonization Project had been established as a rural community with Government aid "for the public purpose of assisting the Territory of Alaska in some of its rural rehabilitation problems and making it possible for worthy and qualified persons to acquire for themselves and families suitable tracts of land in Alaska on small long-time payments not procurable through ordinary commercial channels." * * * (R. 58-59). It is further recited that the Association had been chartered by the Territory of Alaska under the sponsorship of the Alaska Rural Rehabilitation Corporation "in order to assist in carrying said policies and purposes forward for the public welfare and for the benefit of those living in the area * * *," and that the Alaska Rehabilitation Corporation had executed a separate contract with the Association to lend it financial assistance "and act as its Management and Sales Agency" (R. 59). Here, again, the evidence shows that the Association, shortly after acquiring properties in 1940, rejected the financial aid proffered (R. 358) and eliminated the use of the Alaska Rehabilitation Corporation as its management and sales agency (R. 361).

In paragraph (1) the Producer agrees to subscribe for a share of stock for $5.00 and to be bound by the by-laws, rules and regulations of the Association (R. 60).

In paragraph (2) the Association agrees to buy, and the Producer agrees to sell to the Association all agricultural products produced or raised by or for him or

acquired by him, except those reserved for farm or other personal use, and to deliver them in marketable condition to the Association (R. 60).

Paragraph (3) indicates the varied nature of the agricultural products for the marketing of which the contract was drawn. In this paragraph it is agreed "That the term 'agricultural products' as used herein includes horticultural, viticultural, forestry, dairy, poultry, bee and farm and ranch products and also includes such livestock raised for the market as the Association accepts for resale" (R. 61).

Paragraph (4) provides for advances to the producer in the discretion of the Association (R. 61-62).

In Paragraph (5) the Association agrees to market and resell the agricultural products delivered, performing processing and other services in connection therewith, and to pay therefor "as set forth in this Contract" (R. 62).

In Paragraph (6) the Producer agrees that the Association may establish "pools by grades" of any products delivered, and commingle them "with other like products delivered by others" and remit the net average price received therefor after making deductions authorized in the contract (R. 62).

In Paragraph (7) the Association agrees to pay to the Producer the amount received for the resale of such products after making deductions for the repayment of advances, reasonable charges for its services in receiving, handling and selling the agricultural products, operating and maintenance expenses, one dollar per year

for its official publication, and two per cent of the gross sales price received for capital and other purposes mentioned (R. 63).

By the terms of Paragraph (8) the Association is authorized "to process or manufacture into changed or new products" any products delivered and either pay therefor as provided in the preceding Paragraph (7) "or at its discretion to pay a flat delivery price therefor to the Producer as full payment thereof, to process or manufacture the product at its own expense and retain the full proceeds thereof" (R. 64).

Paragraph (9) provides for grading and kindred operations (R. 64).

Paragraph (10) authorizes the Association to borrow moneys and pledge products "as the absolute owner thereof" (R. 64-65).

Paragraphs (11), (12) and (14) relate to consumer purchases by shareholders. Under (11) the Producer agrees to purchase exclusively from the Association (R. 65) and under (12) the Association agrees to return to the Producer from the retail price received from him for all cash purchases a semi-annual patronage dividend, determined after making deductions therein listed (R. 65-66). Under Paragraph (14) the Association makes clear its policy to sell products to shareholders on a cash rather than a credit basis (R. 66-67).

The remaining paragraphs contain provisions as to remedies of the Association and other matters similar to those usually found in a co-operative marketing contract (R. 66-71). Paragraph (19) provides that the con-

tract shall remain in effect "continuously hereafter, subject to legal limitations, if any" and cannot be amended except by two-thirds of all members of the Association at an annual meeting or at a special meeting called upon 15 days' notice, under procedure therein set forth (R. 69-70).

Now, in a case of this kind there is scarcely any principle more fundamental than that all provisions of such a contract are to be construed together to effectuate its purpose.

United States v. Lewis et al. (D.C., N.D. Calif. 1939) 29 F. Supp. 512;

12 Am. Jur., "Contracts," 772-776, Sec. 241.

The Member's Standard Marketing Contract, it must be kept in mind, was executed by the Association with all shareholders who produced and sold their varied products to it, whether they were dairymen or other producers (R. 377).

It is evident that the purpose of the contract was to further a rather broad business venture on a non-profit but self-supporting basis, in which all the shareholders could market varied products on favorable terms and likewise purchase needed supplies and commodities of various kinds.

We would lose sight of the forest for the trees if we did not recognize at the outset that the interpretation placed upon the contract by the appellee would completely defeat this purpose. Appellee would have the Association pay all profit credited to a particular department in a given year even though the Association as

a whole incurred a heavy loss. This would convert the marketing contract into a mutual suicide pact. The cooperative regularly made a profit in some departments and suffered losses in others from the start of its business. It is clear that if the Association had followed Appellee's interpretation it would have failed long ago (R. 376).

At the trial below, the only answer to this point suggested by plaintiff's counsel was: "Well, but that doesn't alter the fact that you were buying that milk under a contract as set forth in Paragraph (7)" (R. 376). Such an answer disregards the fact that there are many more paragraphs in the contract than the one numbered (7) and emphasizes the need of considering the long-established practice of the parties, also.

2.

The Interpretation of the Contract Under Long-Established Practice of the Parties Is to Be Given Great, if Not Controlling Consideration.

It is a significant fact in this case that the contract before us was a printed form put in use by the Association and its producer-shareholders many years ago, prior to 1937 (R. 168). It would be unusual if it were not necessary occasionally to refer to the body of practice built up by the parties since then in determining what their rights might be. This long-established practice might be significant in one of several ways:

(1) It could even prevail over the plain terms of the contract, as showing a modification made by the parties since its execution.

Texas Cotton Co-operative Ass'n. v. Lennox
(1923) 113 Tex. 273, 37 S.W.(2d) 331, 336.

At least two provisions of the contract have been assumed by plaintiff to have been modified through practice. One was Paragraph (12), requiring semi-annual payment of patronage dividends on purchases made by shareholders from the Association (R. 65-66). The undisputed evidence is, that no such dividends had been paid at all. Instead, the Association issued ten-year notes or "certificates of equity" to the purchaser-shareholders entitled thereto, in lieu of cash (R. 363-364). Another provision modified was paragraph (7) (e) (R. 63), providing for a deduction of "2% of the gross sales price for the products of said member sold" for purposes therein referred to. At the same time that plaintiff urged that this paragraph be applied literally and rigidly in other respects, his own witnesses testified that whenever a 2% deduction was made, it was upon the price paid to the producer, not upon the "gross sales price"; 2% of the gross sales price would have been a substantially greater deduction (R. 202-203).

(2) It could prevail as embodying "rules, regulations and directions from time to time prescribed by the Association or its duly authorized officers and agencies covering production, marketing and sale of agricultural products * * * and other co-operative activities," referred to in Paragraph (1) of the contract, to which the producer agreed to be bound. The provision that a producer shall be bound by future, as well as

by present, rules, regulations or directions, is a valid one:

> *Watertown Milk Producers Co-operative Ass'n. v. Van Camp Packing Co., et al.* (1929) 129 Wis. 379, 226 N.W. 378, 379.

Action with respect to annual distribution of Association profit was regularly taken by motion of the shareholders and board of directors as we have noted. Such would come within the meaning of "rules, regulations and directions" under Paragraph (1) of the contract.

(3) At the least, it would be a very important, if not a controlling, factor in interpreting the contract:

> *Holbrook v. Petrol Corporation* (C.C.A. 9, 1940) 111 F.(2d) 967;
>
> *District of Columbia v. Gallaher*, 124 U.S. 505, 31 L. ed. 526;
>
> *Loomis Fruit Growers Ass'n. v. California Fruit Exchange* (1932) 128 Cal. App. 265, 16 P.(2d) 1040;
>
> *Boyle v. Pasco Growers Ass'n.* (1932) 170 Wash. 516, 17 P. (2d) 6;
>
> *Carlyle v. Majewski* (1933) 174 Wash. 687, 26 P.(2d) 79;
>
> 12 Am. Jur. "Contracts," pp. 787-790, Sec. 249.

The United States Supreme Court in *District of Columbia v. Gallaher*, 124 U.S. 505, *supra*, stated:

> "We think that the practical construction which the parties put upon the terms of their own contract, and according to which the work was done,

must prevail over the literal meaning of the contract, according to which the defendant seeks to obtain a deduction in the contract price."

In *Holbrook v. Petrol Corporation,* 111 F.(2d) 967, *supra,* this court quoted with approval the following language from the United States Supreme Court in *Brooklyn Life Insurance Co. v. Dutcher,* 95 U.S. 269, 273, 24 L.ed. 410:

> "There is no surer way to find out what parties meant, than to see what they have done. Self-interest stimulates the mind to activity, and sharpens its perspicacity. Parties in such cases often claim more, but rarely less, than they are entitled to. The probabilities are largely in the direction of the former. In considering the question before us, it is difficult to resist the cogency of this uniform practice during the period mentioned, as a factor in the case."

3.

The Long-Established Procedure, Controlled by the Dairymen, Was for the Association to Distribute or Credit Any Profit It Made Back to Those Shareholders Who Sold Products to or Purchased Them from the Association in Profit-Making Departments.

The point cannot be emphasized too strongly that the starting point for making any annual payment or credit to shareholders who sold products to or purchased them from the Association, was its annual net profit. The practice in this respect had been started when the Co-operative acquired its properties in 1940 (R. 572-574). The profit or loss shown on the Association's books for each of its several departments was

significant only in allocating the Association's profit to each of the Departments to which a profit was credited. This in turn was an intermediate step in computing the amount which the individual shareholders were to be paid or credited who sold products to, or purchased them from, the Association in any profit-making department.

The procedure involved was described by three persons familiar with it, all three having been called as witnesses by plaintiff. Mr. L. C. Stock outlined the general procedure briefly (R. 573-576). He had served at different times as president, manager and board member, and had played a leading part in establishing it when the Association commenced its operations (R. 570-572). Mr. Snodgrass gave a clear and complete explanation of it (R. 352-354, 361-365, 374-376, 453-456, 472-476). He had served as a director from 1941 through November, 1944 (R. 335) and as manager from January, 1944, until February, 1946 (R. 345). Mr. Marvin Allyn supplied details (R. 249-253); he had been chief accountant and assistant general manager of the Association (R. 248).

The procedure was as follows: Each Spring the Association employed an outside firm of public accountants to make an audit of its books for the preceding fiscal year, i.e., December 1 through November 30 of the preceding calendar year. The auditor set forth the actual profit or loss of the Association, and also computed the profit to be credited to each department. He had a record of sales as to each, and a record of "direct overheads" such as salaries of persons employed therein.

However, he had no standard based upon factual data for allocating "indirect overheads" so he applied a deduction of 12.494% of its gross sales therefor as to all departments.

The audit was presented to and approved by the shareholders at their annual meeting. Then the Board allocated all or a substantial part of the profit of the Association to each of the departments, and those only, which showed a profit for the preceding fiscal year. This allocation was made in the proportion that the profit of each department bore to the profit of the Association as a whole (R. 374).

As we have seen, the Association did not pay any money to shareholders who patronized the "consumer departments," instead, it gave them 10-year "certificates of equity," or notes, in an amount as to each proportioned upon his dollar purchases from the department (R. 362). The cash reserve created thereby was the only means provided for by the Association to pay its indebtedness to the government.

The Association made payments to producers in cash (R. 362). Each producer who had sold agricultural products in a profit-making department would receive his share of the Association's profit allocated thereto in proportion that his dollar sales bore to the dollar sales of other producers to it (R. 351-352).

Counsel for appellee may be challenged to point out any place in the record where any witness with direct knowledge of the Association's accounting or practice testified otherwise than in accordance with the forego-

ing. There are statements made by certain witnesses to the effect that it was the entire profit of each profit-making department that was distributed. On the face of things, this would not be possible because the Association had no way of making up for the losses in other departments (R. 376). Furthermore, each of the witnesses who made any such statement will be found to lack knowledge of what occurred. Thus the plaintiff himself admitted that he had no knowledge of how the amount he sued for had been calculated (R. 236-237), even though he testified that regular reports had been given at annual shareholder meetings as to the method of arriving at any annual payment (R. 239-240). Other witnesses stated that although they had access to the Association's books at any time they never had looked into the matter (R. 176, 413).

Now, it should be kept in mind that throughout this period, it was the *dairymen* who were in control of the Association's Board, and in charge of making or crediting Association profits to producers and consumers. Of the seven members on the Board, at least four were dairymen and sometimes there were five (R. 491, 575). During the Association's profit-making years 1941 through 1944 they were satisfied (R. 194). It was not until the audit made in 1946 disclosed that there was at most only about $2,800 profit for the entire Association for the fiscal year 1945, that this controversy arose.

The plaintiff-dairymen then wanted the full $57,001.58 credited to their department, and took the position that it was little short of outrageous that the large share of this sum should be applied to "subsidize" de-

partments which showed a loss. Yet this is precisely what the Association had done since it was chartered. The fact that it had authority in its Articles itself is a significant answer to plaintff's complaint, because losses in certain departments must have been contemplated from the start;

> *Washington Co-operative Egg & Poultry Ass'n. v. Taylor* (1922) 122 Wash. 466, 210 Pac. 785.

Other facts must be kept in mind on this subject. It was the Association as a whole which had financed the acquisition of the rather extensive dairy-creamery plant and facilities, not the dairymen alone (R. 327). Prior to this acquisition, the dairy-creamery department itself had been a losing one, and it undoubtedly was the extensive program undertaken by the Association to improve it that converted it into a profit-making one (R. 473). Too, the dairymen regularly patronized the losing departments and presumably derived benefits from them through patronage (R. 323-325, 327-332). They also benefited through distribution of the general overhead; the dairy-creamery department would lose a large part if not all of the profit credited to it if it were operated alone (R. 482).

4.

Paragraph (7) of the Contract Does Not Determine the Question Presented by This Appeal.

The plaintiff contended, and the court below took the view, that the question presented by this appeal is governed by paragraph (7) of the contract (R. 590-595).

We submit that this is incorrect. However, we shall urge, under heading 5 hereof, that even if this paragraph were held to apply, this court still should rule for Appellant because the deductions therein authorized, under the practice of the parties, covered allowance for obligations of the Association including maintenance of departments which suffered a loss. Under heading 6 hereof we shall submit what is believed to be the sounder view, that the practice of the parties, taken in connection with paragraph (8) indicates that the Association was purchasing the milk for cash and declaring a dividend in proportion to sales when a net profit was available therefor.

It is well to set forth the related paragraphs (6), (7) and (8) of the contract together:

> "(6) Producer agrees that the Association may establish or cause to be established through its Management and Sales Agency daily, weekly, monthly, seasonal, yearly, and/or other pools by grades of any agricultural products received from its members and may co-mingle or pool any of the products delivered hereunder with other like products delivered by others or cause same to be done and remit or cause to be remitted to the Producer and other producers concerned, on the basis of the interest of each one therein, as payments in full for the products delivered by them and sold in said pool, the net average price received therefor after making the deductions provided for in this Contract with the object of causing all members whose products are sold therein to receive the same price for products of the same grade.
>
> "(7) The Association agrees to pay or cause to

be paid through its Management and Sales Agency to the Producer the amounts received for the said re-sale of said products sold separately or the amounts representing Producer's interest in products resold wherein his products are pooled or co-mingled with others as provided for in Paragraph 6 herein after making deductions to cover the following items in connection therewith: (a) repayment of advances made to Producer under Paragraph 4 of this Contract and interest on said advances; (b) reasonable charges for the services of receiving, handling and selling said agricultural products under Paragraph 5 of this Contract; (c) operating and maintenance expenses; (d) one dollar per year in payment of the official publication of the Association in case said publication is issued; (e) two per centum (2%) of the gross sales price received for the products of said member sold separately or of the amounts representing said member's interest in products sold wherein his products are pooled or co-mingled with others as funds belonging to the Association to meet its indebtedness and additional expenses, contribute to the Association's reserves (with which to acquire ownership of industries and enterprises and property in connection therewith and for other proper purposes), to pay interest on capital stock by way of dividends and for other proper purposes as provided for by the laws of Alaska pertaining to 'Co-operative Associations' under which the Association has been incorporated and by the By-laws of the Association.

"(8) The Association is hereby authorized to process or manufacture into changed or new products the products delivered hereunder and pay the

Producer as provided for in Paragraph 7, from the proceeds from resale of the changed or new products or at its discretion to pay a flat delivery price therefor to the Producer as full payment thereof and thereafter process or manufacture it into changed or new products on its own account and at its own expense as its own product and sell and retain the full proceeds thereof as amounts belonging to the Association."

Attempts to make the undisputed facts of this case fit into paragraphs (6) and (7) is like attempting to put together a picture-puzzle only to find that a number of pieces are left out while others do not fit into the pattern. There are a number of points to be considered in this regard:

(a) Paragraph (7) applies by its terms only if the Producer's products "are pooled or commingled with others as provided for in Paragraph 6 herein," unless they were "sold separately," as they were not. Now paragraph (6) provides a procedure by which the Association may establish pools "by grade" and "may commingle or pool any products delivered hereunder with other like products" delivered by others. The "object" is that of "causing all members whose products are sold therein to receive the same price for products of the same grade."

This language is significant. What is contemplated is, that "like" products "of the same grade" be commingled. Underlying this is the plain inference that such "like products" should be kept identifiable and not mixed with unlike products; they must be identifiable in order to follow their course of resale so that

"the amounts received for the said resale of said products * * * pooled or commingled with others as provided for in paragraph 6 herein" might be determined, in accordance with the terms of paragraph (7).

The practice of the parties was entirely different from that. Grade A milk was mixed with Grade B milk in the manufacture of various products. Then both grades of milk were commingled with various manufactured products. These products, which the accountant classified under the heading of the "creamery" operations in the dairy-creamery department, included the following: ice cream, popsicles, malted milk, chocolate milk, butter and powdered milk (R. 297). Then the Association had no egg department, so it handled the eggs that were produced by its shareholders and also eggs purchased on the outside for resale, as part of the creamery-dairy department (R. 276-7). The income from all these products was credited to the creamery-dairy department at Anchorage and it was impossible to make any segregation of income derived from any one of them (R. 258, 567-568), or even any segregation of the group of products classified as "creamery" from those classified as "dairy" (R. 298, 566-567). The accountant brought the Association's books into the courtroom so that counsel for plaintiff might try his hand at making any such segregation, which he did not (R. 569).

(b) If paragraph (7) were interpreted to apply to a pool conducted in accordance with paragraph (6) the dairymen in normal course would have insisted upon an accounting covering the proceeds of their milk at

the end of each two weeks or at least at the end of each month. Why would they wait until the Spring of the year following for their settlement, as they did? Paragraph (6) itself refers to "daily," "weekly" and "monthly" pools. The evidence is undisputed that by the end of each bi-monthly period the Association ordinarily had re-sold the milk delivered during the preceding two weeks (R. 513). It could have responded to a demand on the part of producers to account and remit the proceeds of resale under paragraph (7) at that time, if it could do so at all.

(c) Appellee, in order to explain the regular bi-monthly payments to producers for milk delivered must classify them as "advances" in order to avoid the connotation of "price," especially "flat delivery price" as employed in paragraph (8) of the contract. Viewed thus as voluntary payments, the Association might make them or not at its discretion. This would imply that the dairymen might be obliged to deliver their milk for the full year before getting any payment at all; see

Kansas Wheat Growers' Ass'n. v. Schulte
(1923) 113 Kan. 672, 216 Pac. 311, 315.

Such an interpretation would disregard not only the course of business adopted by the parties but also the most rudimentary facts pertaining to the dairy industry, wherein farmers must be paid promptly for their product or go out of business.

(d) The only mention in the contract of "advances" is in paragraph (4) thereof and it is clear that the framers of the contract intended by this word an en-

tirely different meaning than that placed upon it by plaintiff. Paragraph (e) provides:

> "The Association agrees that upon delivery of agricultural products hereunder it may make or cause to be made through its Management and Sales Agency such requested advances to the Producer on said products as in its discretion may be justified by the Producer's immediate needs and by marketing conditions."

By "advance" is meant a loan, under this paragraph. This is frequently true of this word in marketing contracts, as in

> *McCauley v. Arkansas Rice Growers' Co-operative Ass'n.* (1926) 171 Ark. 1155, 287 S.W. 419, 425.

where a loan to pay off a producer's mortgage was involved.

Paragraph (4) is clearly inapplicable. It refers to "requested" advances and no request was made therefor by producers (R. 192). Also, it mentions the "producer's immediate needs" whereas re-sale prices governed the payments, which were made to all producers alike (R. 573-574). Also, paragraph 7a provides for the deduction from the resale price of the product delivered of an amount "for repayment of advances made to producer under paragraph (4) of this contract and interest on said advances." No interest was ever charged (R. 192).

Finally, the only papers employed by the parties in which the word "advances" was employed were certain "remittance advices" and here the word is used to in-

dicate that bi-monthly payments had been made for milk "purchased." These "remittance advices" are illustrated by the exhibits of the plaintiff (Exhibit 5, R. 225; Ex. 8, R. 403; Ex. 10, R. 430; Ex. 13, R. 434; Ex. 16, R. 441 and Ex. 17, R. 525). One of these reads as follows:

"PLAINTIFF'S EXHIBIT NO. 8 (R. 403)

"Remittance Advice—No Receipt Required

"Matanuska Valley Farmers Cooperating Association

"Palmer, Alaska

"Date of Invoice	Description	Gross Amt.	Discount or Deduction	Net Amt.
	Second 'milk pool' advance:			
	Total amount purchased	$1,947.26		
	20% of dollar value purchased		$389.45	
	Less 2% statutory reserve		7.79	
	Amount of second advance			$381.66

(Endorsed)
Clarence Quarnstrom"

Notice that this paper calls the total dollar amount of the bi-monthly deliveries during the year "total amount purchased". The word "advance" is used obviously only in the sense of "payment". The payment is computed as to the individual purchaser as "20% of dollar value *purchased*". This was the Association's way of apportioning its profits to the individual producer.

5.

Even if Paragraph (7) Were Held to Govern, When Interpreted in the Light of the Practice of the Parties, It Would Support the Position of Appellant Herein.

Under Paragraph (7) the Association agrees to pay "the amounts received for the said resale of said products" after making the following deductions:

> "(b) Reasonable charges for the services of receiving, handling and selling said agricultural products under Paragraph 5 of this Contract;
>
> "(c) Operating and maintenance expenses;
>
> "(d) One dollar each year in payment of the official publication of the Association in case said publication is issued;
>
> "(e) Two per centum (2%) of the gross sales price received for the products of said member sold separately or of the amounts representing said member's interest in products sold wherein his products are pooled or co-mingled with others as funds belonging to the Association to meet its indebtedness and additional expenses, contribute to the Association's reserves." (R. 63)

Now plaintiff based his demand for the sum deemed owing the dairymen by a process of reasoning illustrated by his Exhibit No. 3 (R. 182). In doing so, he took into account part of the Association's obligations, namely $83,807.54 for "Operating Expenses" and $45,-121.31 "Indirect Overhead".

In restricting the "indirect overhead" to the sum of $45,121.31, however, plaintiff overlooked entirely the purpose that the accountant and the Association had in using that figure, and their method of treating "in-

direct overhead''. This was explained in detail by Mr. Allyn (R. 265-267) and by Mr. Snodgrass (R. 314-321, 504- 505, 521-522). The Association did not have a system of cost accounting, so it adopted a rule-of-thumb for want of a better standard in computing the profit credited to each department. This was solely for the purpose of guiding management in allocating the profit of the Association. What was done was to deduct a flat 12.494% of gross revenues in each department, regardless of sales or mark-up. The exception was, that only 7/12 of the amount deductible under this formula was charged to the Produce Department, on the theory that it was operating only five months out of the year and hence burdening the Association with cost (R. 314-317).

It is clear that this formula would be relevant only if applied to determine the cost of each department for the purpose of allocating the $2,800.00 for the year 1945, assuming that this amount could have been properly distributed (R. 352).

We come back, then, to the fundamental principle, that an interpretation of paragraph (7), as well as other provisions of the contract, must be made in view of the long established practice of the parties. As applied to paragraph (7) the following authorities are noteworthy in illustrating how a rigid, literal interpretation is to yield to the one adopted by the parties:

District of Columbia v. Gallaher, 124 U.S. 505, 31 L. ed. 526;

Holbrook v. Petrol Corporation (C.C.A. 9, 1940) 111 F.(2d) 967;

Carlyle v. Majewski (1933) 174 Wash. 687, 20 P.(2d) 79;

12 Am. Jur., "Contracts," 787-790, Sec. 249.

6.

In Practice the Parties Applied Paragraph (8); the Bi-Monthly Payments Were Prices for Milk Delivered on Cash Sales and the Annual Payments Were Dividends Proportioned Upon Such Sales.

At the trial below, plaintiff's counsel asked witnesses repeatedly whether any agreement had been concluded between the Association and the dairymen for the payment of a flat delivery price under paragraph (8). Of course he received a negative reply from some of the witnesses. The question calls for a conclusion of law, not for facts. Furthermore, paragraph (8) does not contemplate any supplementary agreement between the Association and the producer on the matter of delivery price. By the express terms of paragraph (8) the "Association is . . authorized . . at its discretion to pay a flat delivery price" (R. 64).

In 1 Alaska Compiled Laws Annotated, 1949, Sec. 29-1-1 being the Uniform Sales Act, a contract of sale and a sale are defined as follows:

> "Sec. 29-1-1 Contracts to sell: Sales. (1) A contract to sell goods is a contract whereby the seller agrees to transfer the property in goods to the buyer for a consideration called the price.
>
> "(2) A sale of goods is an agreement whereby the seller transfers the property in goods to the buyer for a consideration called the price."

We submit that under the well-established practice

of the parties, the bi-monthly payments in substance were prices for milk delivered on cash sales, and that the annual payments or credits were in the nature of patronage sales dividends. We emphasize, however, that the position of appellant, in urging that the judgment of the court below be reversed, does not turn upon this point. The question presented in this case relates to the determination of when and how the annual payment or credit is to be made. We submit that there is just one sound answer to that question irrespective of whether the contract and the practice of the parties is viewed as establishing an agency or a sales relationship.

Whether an agency or sales relationship is established in a given case can be determined, of course, only by an examination of all terms of a particular contract, taken in relation to the practice of the parties. Examples where a co-operative marketing contract has been held to be one of sale are:

> *Neith Co-operative Dairy Products Ass'n. v. National Cheese Producers Federation* (1934) 217 Wis. 202, 257 N.W. 624;
>
> *Texas Farm Bureau Cotton Ass'n. v. Stovall* (1923) 113 Tex. 273, 253 S.W. 1101.

When paragraph (8) is examined on this basis, a number of related points are presented:

(a) Paragraph (8) authorizes the Association to pay a flat delivery price as to all products delivered as it "may process or manufacture . . . into changed or new products". It is submitted that pasteurizing milk constitutes a "manufacture", or at least a "process" within the meaning of this language just as the Asso-

ciation's making other products was such. The process involved was explained clearly by the witness Mr. Snodgrass (R. 500-561), as follows:

The milk is dumped into a weighing vat at Palmer and the weight is recorded on a slip. It is then dumped into a pump vat and a sample is taken for testing butterfat content. A certain amount is kept out and separated. In the Summer when the milk test is low, cream is put back into the milk in order to raise the test from the average of that received from the producers to the average at which the Association markets it. In the Wintertime, skim milk is put back in to lower the average, and keep the butterfat content of the milk sold uniform the year through. Then the milk is hauled to Anchorage in a 1200-gallon stainless steel thermos bottle truck. There it is pumped into pasteurizers. After pasteurization it is run through a cooler, which reduces the temperature from 143 degrees down to about 50 degrees, and then it is bottled and capped in a bottling machine and placed into the cooler until delivery.

It is submitted that the milk has been "changed" with regard to such physical characteristics as butterfat content, sterilization, cooling, bottling and in other respects. The finished product is made fit for wider markets, and commands much more in the way of price.

Webster's New International Dictionary (2nd Ed.) defines "Process" as follows:

> "Process * * * a. To heat, as fruit, with steam under pressure, so as to cook or sterilize. b. To subject (esp. raw materials) to a process of manufac-

ture, development, preparation for the market, etc.; to convert into marketable form, as livestock by slaughtering, grain by milling, cotton by spinning, milk by pasteurizing, fruits and vegetables by sorting and repacking."

If the farmers of the Matanuska Valley needed legal support for this interpretation of paragraph (8), they had it in the form of a holding of the District Court for the Northern District of Washington, decided some years before the Member's Standard Marketing Contract was put into effect:

In re Alaska American Fish Co. et al. (D.C., W.D. Wash. 1908) 162 Fed. 498.

The court stated therein:

"The home office and principal place of business of the Washington corporation is at the city of Tacoma, its business was catching, preserving by salt, and marketing salt water fish, and it owned a plant for carrying on that industry in Alaska. Fish, as a commodity of merchandise, requires the application of process for its preservation, as well as labor in placing the same in suitable receptacles for handling and transportation. Therefore, I hold that the business of said corporation was a manufacturing business within the meaning of the bankruptcy law, and that it is subject to be adjudicated a bankrupt."

Also supporting their position are:

Gordon v. Paducah Ice Mfg. Co. (D.C., W.D. Ky., 1941) 41 F. Supp. 980;

France Co. v. Evatt (1944) 143 Ohio State 455, 55 N.E.(2d) 652;

In *Gordon v. Paducah Ice Mfg. Co.*, 41 F. Supp. 980, *supra*, the court considered the question whether the furnishing of ice for refrigerator cars used in transporting strawberries constituted the "production of goods for commerce" within the meaning of the Fair Labor Standards Act. The court ruled affirmatively and in the course of its decision referred to an administrative interpretation of the Act to the effect that the pasteurization of milk constituted a processing and "connoted a change in the form of the raw material" (p. 987).

(b) The Association processed or manufactured the milk "at its own expense and as its own product" within the meaning of paragraph (8). Much of what has been said in our discussion of paragraph (7), under heading 4 hereof, is applicable here. The underlying purpose of paragraph (8) would seem to be, to permit the Association to purchase products at a flat delivery price where it uses its plant and facilities, and incurs expense, in processing and manufacturing them so as to materially increase their value or marketability.

(c) Paragraph (8) in this respect is to be construed with paragraph (2), which provides as to passage of title:

> "(2) * * * This contract is intended by the parties hereto to pass an absolute title to all said agricultural products as soon as the same have a potential existence, but they shall be at the risk of the Producer until delivery hereunder, except dairy products and except livestock accepted for resale, and title to these does not pass until delivery thereof hereunder." (R. 60)

(d) The Association did "retain the full proceeds thereof as amounts belonging to the Association" as provided in paragraph (8). We have already described its practice in handling the proceeds of resale, and in maintaining its accounting system, under which the monies received from all creamery-dairy sales were treated as belonging to the Association.

(e) The bi-monthly payments were substantial and represented a quid pro quo for the milk delivered. From April 22, 1943 until August 1, 1945 this price was $6.70 per hundredweight of milk with four per cent butterfat test with a differential of six cents per hundredweight for each 1/10 of 1% butterfat above or below 4%. On September 1, 1945 this price was increased to $7.20 and on September 16 to $7.70, with the same allowance for butterfat differential (R. 349-350). In addition, a "winter bonus" of so much per hundred was paid during winter months to stimulate production. This was 50c per hundredweight from September 1, 1944 to March 1, 1945 (Defendant's Exhibit 9, R. 558).

Such prices compared favorably with those paid elsewhere for milk. With the exception of the years 1940 and 1941 the dairymen received from the Association about 50% of the consumer's dollar, *i.e.,* the amount paid by the consumer at the point of purchase for final consumption, without including any annual payment or "overage" (R. 346-347); with the annual payment, this ran about 60% in those years (R. 347). In other places, the range for the corresponding period was from about 40% to about 60% with the average about 50% (R. 348).

(f) What the producers received when they delivered their milk were in substance sales slips, not slips referring to any advance. The slips showed the number of pounds of milk the producer delivered, the butterfat test, the price of the milk and the amount of money to be paid to him (R. 210-211, 437).

7.

Payment of the Amount Demanded Would Constitute a Payment Out of Capital in Violation of the Laws of Alaska, the Articles and By-Laws of the Corporation.

The principle involved is stated in Fletcher, Cyclopedia of Corporations, Sec. 5329, as follows:

> "It is a well-settled principle that, as between the stockholders of a corporation and its creditors, the assets of the corporation are, in a sense, a trust fund for the payment of its debts, and they cannot lawfully be distributed among the stockholders, even in part, to the prejudice of creditors. * * * It is a settled rule, therefore, even in the absence of any statutory provision, that a corporation cannot lawfully declare dividends out of the corporate stock, and thereby reduce the same, or out of assets."

The provisions of the statute on Cooperative Business Corporations, under which appellant is incorporated, make it clear that dividends are to be payable only out of net earnings. This statute, being Title 26, Alaska Compiled Laws, 1949, Sec. 36-3-8 and following, provides:

> "Sec. 36-3-8. *Disposition of earnings.* The directors, subject to revision by the Association at any regular or special meeting and not less than once

each year, shall apportion the earnings of the association by first paying a dividend on the paid up capital stock, not exceeding eight per cent per annum, then setting aside not less than ten per cent of the net profits for a sinking fund, to be used in accordance with the by-laws of the association, and five per cent thereof for an educational fund to be used in teaching co-operation, and the remainder of said net profits shall be prorated by a uniform dividend to its several stockholders or other customers upon their purchases from, or sales to, said association or both such purchases and sales, and upon salaries of employees. (L. 1917, ch. 26, Sec. 8, p. 50; C.L.A. 1933, Sec. 998)"

Statutes imposing personal liability on corporate directors for the payment of dividends out of capital have been construed to apply to co-operative as well as to other types of corporations:

Breon v. Ford (1924) 182 Wis. 616, 197 N.W. 195;

Casterland Milk & Cheese Co. v. Shantz (1919) 179 N.Y.S. 131.

In *Breon v. Ford,* 197 N.W. 195, *supra,* the court stated:

"Applying this principle to the contents of the 5th paragraph we reach the conclusion that the pleader intended to and did allege what the defendants received were only the customary trade discounts that were given by stores generally in that vicinity to their customers, and that these discounts were given to all customers of this company whether members or not. So construing the answer, we think that the trial court erred in sustaining the

demurrer. If the proof should disclose that the so-called discounts were not ordinary trade discounts but were in fact dividends declared out of capital and not out of net profits, then there would be liability on the part of the defendants to repay them."

In *Casterland Milk & Cheese Co. v. Shantz,* 179 N.Y.S. 131, *supra,* the plaintiff-co-operative sued a shareholder to enforce a co-operative marketing contract. The defense and counter-claim set up by defendant was that plaintiff had failed to pay a dividend as agreed in the contract. The court used this significant language in disposing of this point:

"The defendant sets up, both as a defense and counter-claim, the failure of the plaintiff to pay dividends upon the capital stock and also certain over-payments of dumpage which he claims was deducted by plaintiff from his dividends. It is quite true that the agreement provided for the payment of dividends at the rate of 5 per cent per annum but in making this agreement the parties must be presumed to have had in mind the provision of the Stock Corporation Law which forbids directors declaring dividends except from surplus profits, and the agreement must be read and construed in connection with that statute." (pp. 134-135)

By the same token, the common law prohibition against the payment of dividends out of capital would apply to a co-operative association and its marketing contract would be construed in reference thereto.

We have noticed that the Articles and By-laws of the Corporation are adopted as part of the Standard Member's Marketing Contract by the express terms of para-

graph (1) thereof (R. 60). Even in absence of such a provision, it has been held that a member's contract with a non-profit corporation must be construed with its Articles and By-laws, and that if there is any conflict the terms of the latter govern:

> Fletcher, Cyclopedia of Corporations (Perm. Ed.) Sec. 4198;
>
> *Miller v. National Council Knights and Ladies of Security* (1904) 69 Kan. 234, 76 Pac. 830;
>
> *Order of United Commercial Travelers of America v. Nicholson,* 9 F.(2d) 7.

Appellant's Articles of Incorporation were drawn to conform with the above statute. Article III, Sec. 2 thereof provides:

> "Non-cumulative dividends in the nature of interest only and not to exceed eight per cent per annum may be paid upon each share of stock if, as and when declared, and net earnings may be apportioned in accordance with patronage after the setting aside of the required reserves, as are provided for in the Compiled Laws of the Territory of Alaska, 1933, pertaining to 'Co-operative Associations' and as are further set forth in the by-laws of this Association. This Association is formed to function on a co-operative basis for the mutual benefit of its members and on account of this fact dividends which are herein regarded simply as interest have been restricted as herein set forth."

In conformity with the foregoing provisions of the Articles, Section 3 of Article XII of the By-laws provides:

> "Section 3. PRODUCING AND SELLING.

The Board of Directors shall cause to be prepared a Member's Standard Marketing Contract by the signing of which a share of common stock in the Association is subscribed for at the par value of Five ($5.00) Dollars and membership is acquired in the Association and the member is bound to produce, prepare for market and sell all his agricultural products which are for sale to or through the Association or its agencies under such terms as the contract shall provide *and under such rules and regulations as the Association or its agencies shall make, said terms of contract and said rules and regulations to cover all stages of agricultural activities, including production, preparing for market and sale;* the Association to handle and sell such products singly or pooled and return to the member his net proceeds therefrom *after deducting for expense and Association obligations, including reserves and interest on shares of stock and other proper deductions have been made.* Said contract shall contain all other terms which the Board of Directors deem necessary or desirable to make the contract workable and effectual and protect the interest of the Association and its members. The contract shall include in its terms the penalties and remedies which under the laws of Alaska apply to marketing contracts, including liquidated damages, expenses and fees in case of lawsuits, and the rights of injunction and specific performance and shall recite the liability which the law attaches to any inducement to breach the contract or false representations made concerning the finances or management of the Association."

This section, again, makes it clear that any member

sells his produce in accordance with "such rules and regulations as the Association or its agencies shall make", as well as in accordance with the marketing contract itself. Also, the section makes clear that the Association is to pay the net proceeds therefrom after deducting "for Association obligations". These Association obligations are not simply maintenance and operating expenses literally and narrowly construed, but include "reserves and interest on shares of stock and other proper deductions."

Thus the Articles and by-laws of the Association, as well as the statute under which it was incorporated, make it clear that appellant is not entitled to the profit shown in a particular department of the Association where to draw that down would deplete its capital.

In conclusion, the judgment of the lower court should be reversed.

Respectfully submitted,

DAVIS & RENFREW,
HOUGHTON, CLUCK, COUGHLIN & HENRY,
Attorneys for Appellant.

DAVIS & RENFREW,
Anchorage, Alaska,

HOUGHTON, CLUCK, COUGHLIN & HENRY,
535 Central Building,
Seattle 4, Washington,
Attorneys for Appellant.